CHANGE IMPERATIVE
Payroll and Benefits Administration Process Vision

Change Imperative
Payroll and Benefits Administration

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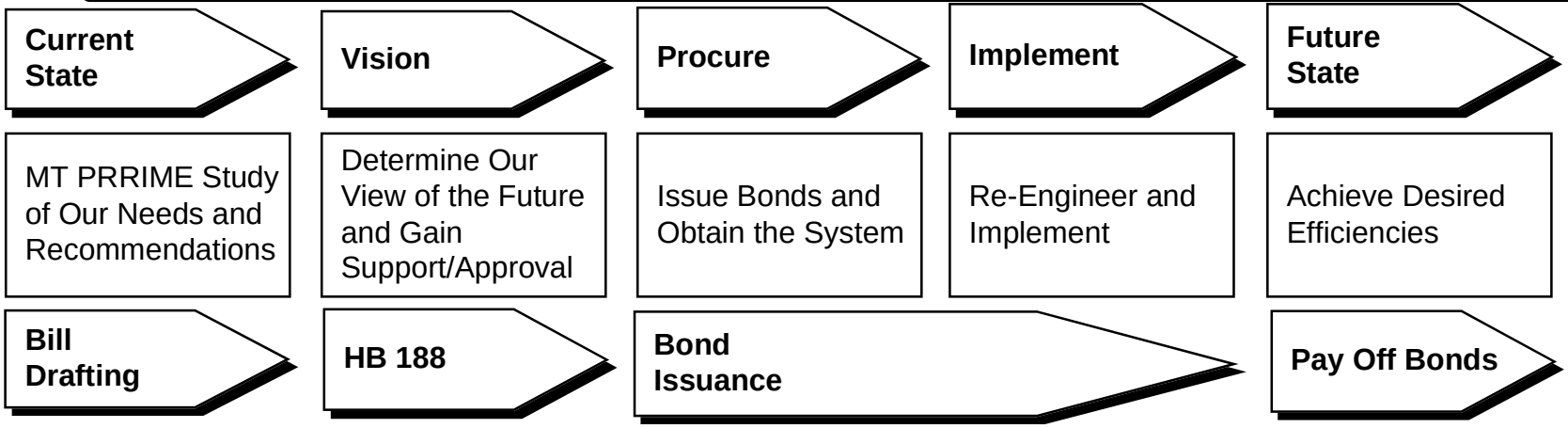
Project Context



- State of Montana operates mainframe-based financial, human resource and asset management applications built 20-25 years ago that are not Year 2000 compliant.
- Current system is failing to meet the needs of State agencies.
- Senate Joint Resolution 23 is the Legislature's decision to re-engineer Montana's information management environment.
- MT PRRIME undertaken to analyze the State's information management environment.
- This phase of MT PRRIME is being undertaken to refine the business case to replace core systems with a third-party, off-the-shelf software solution.

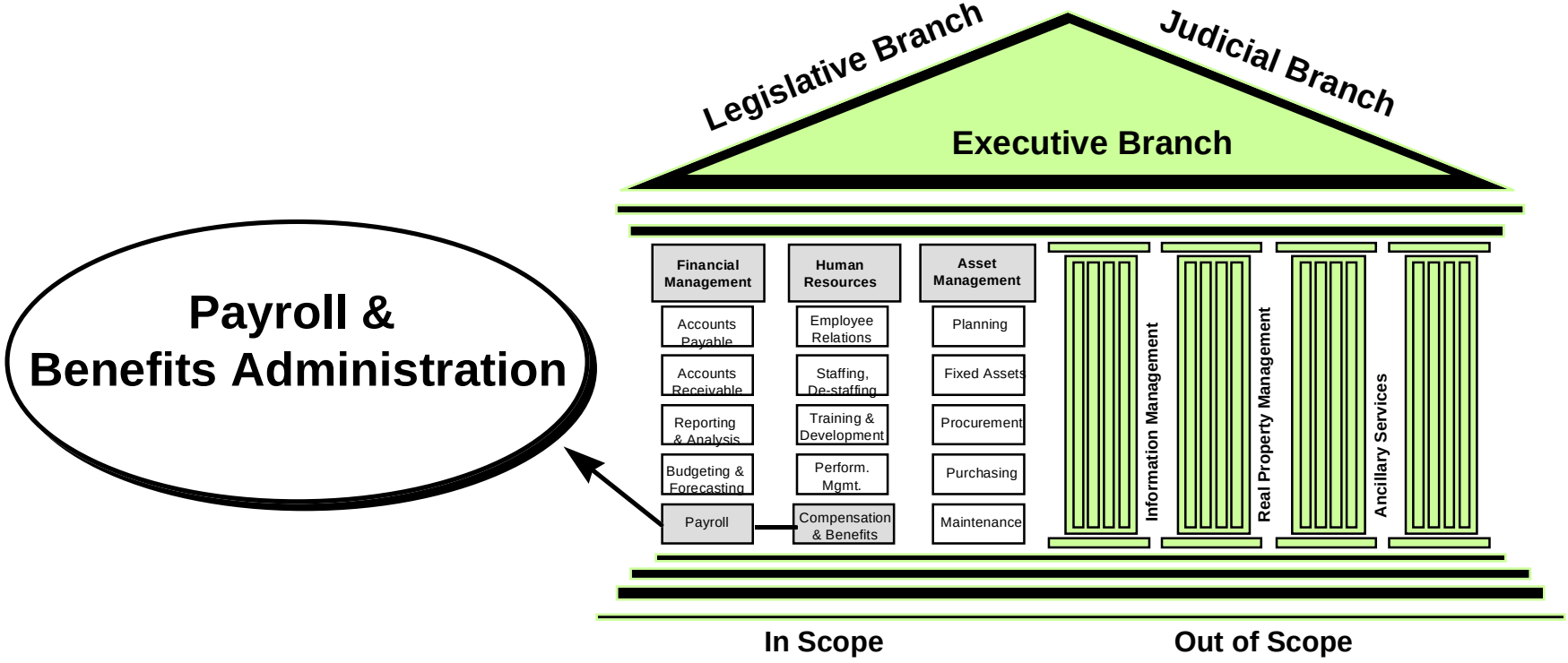
The intent of this phase is to establish an imperative to change based on cost savings from the budgeting, payroll, and accounts payable and purchasing processes.

Project Objectives

- Assess the current processes in the area of payroll and benefits administration.
- Establish the change imperative for these processes.
- Define and develop the vision and concept for the new processes at a level of detail sufficient to guide system selection.
- Define important criteria and values that would guide a systems selection based on a vision for the new processes.
- Where necessary, refine the business case, implementation plan and funding proposal for MT Prime.

Project Scope

Review all aspects of the payroll and benefits administration process within State Government



Project Scope

- This project encompassed an assessment of approximately 12 agencies representing large, medium, and small operations which together make up approximately 75% of the entire state employee base. Two State organizations have also been assessed.
- The characteristics of payroll and benefits administration processing were studied within the agencies rather than specific details.
- The information gathered from interviews and visits to the these agencies is assumed to represent a broad cross section of the State Government.
- Interviews were conducted with a range of personnel from bureau chiefs and payroll supervisors, to pay and accounting clerks.

Project Scope

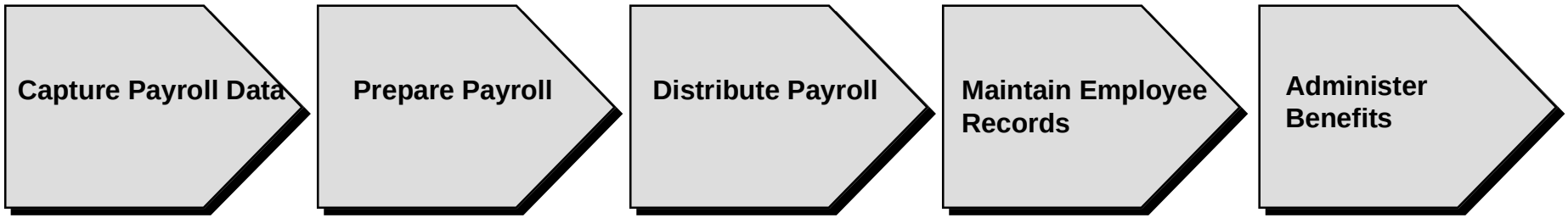
- Payroll and Benefits Administration (P&B) represent just two of the many processes that comprise Personnel Services. P&B was specifically chosen for this assessment because the MT PRIME project identified them as areas in which the processes:
  - Seemed to be broken;
  - Generally lacked the use of innovative or best practices; and,
  - Exhibited high degrees of manual effort.
- Based on these characteristics, the fact that the people involved in payroll processing are typically also involved in benefits administration, and that the processes are large in scope and complexity, it is very likely that there are significant resources being consumed by the processes within each agency and across the State as a whole.

Work Completed

- Interviewed 41 people in 12 State Agencies.
- Determined the level of effort expended for each of the Departments in the area of payroll processing and benefits administration.
- Calculated a cost per payment for each Agency interviewed and then extrapolated to determine the cost to the State as a whole.
- Developed an understanding of Agencies' concerns and requirements for a new payroll information system.
- Interviewed 2 other organizations within the State.
- Compiled payroll cost benchmarking data in order to compare it to the cost of State payroll processing.

High Level Payroll Process

At a high level the payroll process within the State is made up of 5 distinct sub-processes:



- Major activities.
- Collect timesheets.
- Enter time/leave records.
- Edit information.

- Receive time from agencies.
- Edit time transactions.
- Calculate pay and produce reports.

- Print warrants and prepare EFTs.
- Validate warrants for sequence, sorting, and distribution.
- Distribute payments.

- Maintain basic employee data.
- Track payroll related data I.E.. Pay rate, leave, longevity, etc..

- Explain of benefit options.
- Set up payroll deductions.
- Maintain and track benefits related data.

The analysis of payroll cost within the State includes all of the payroll activities that begin with supervisors collecting completed timesheets and end with the distribution of payments to employees. This process includes benefits administration.

Opportunity Assessment

Assessment Components:

Hypothesis
The Size of Payroll
The Complexity of Payroll
Agency Initiatives
The Cost and Efficiency of Payroll
Benchmark Comparison
Findings of Benchmark Research
Readiness to Change

Hypothesis

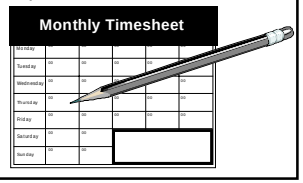
- The next slide illustrates that payroll and benefits administration processes are large and complex and therefore very costly to the State.
- Inefficient processes and inadequate systems drive the cost of payroll and benefits administration to almost double that of comparable reengineered organizations.

= Review/Approval Action

Payroll Process Map

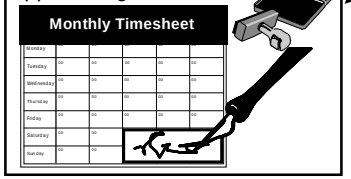
EMPLOYEE

Completes/submits timesheet



EMPLOYEE'S SUPERVISOR

Approval signature



PAYROLL CONTACT IN DIVISION

Clerk collects/summarizes time sheets by pay location; checks signatures/completeness

Summaries/original time sheets to agency Central Payroll

AGENCY CENTRAL PAYROLL CLERK

Time sheet data entered into pre-payroll file downloaded from State Payroll; original time sheets again reviewed for accuracy and completeness; follow-up calls to Local Offices

Some agencies maintain parallel personnel systems (i.e.., in Lotus) allowing more sophisticated reporting/tracking. Data typically re-keyed from original forms

Between cycles, agency Payroll staff enter other pay-associated data (e.g., pay rate changes, exemptions, leave corrections, etc..) into main State Central Payroll

STATE PAYROLL

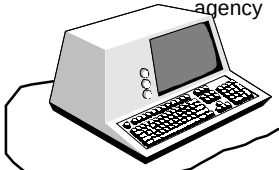
"Edit Update" run 5-10 times until all agency transactions validated

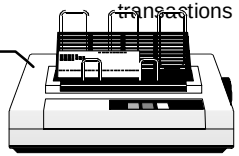
Net pay calculation; deduction monies to vendors; various reports; GL file; month-end bonds; system backup; next cycle pre-payroll files to agencies

Calls to agencies having sent invalid transactions; correct transactions re-entered online into State Central Payroll mainframe; signed change form sent by agency

"Edit Update" run, validating data uploaded from various agencies (about 900 system edits)

Manual inspection of time/ employee data transactions





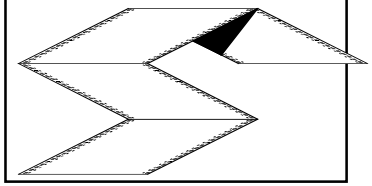
Warrant Writer system warrants/checks printed/validated for sequence, sorting, distribution; EFTs made to various financial institutions; pay advises printed

Warrants, pay advises, reports released for pickup by agencies

AGENCY CENTRAL PAYROLL SUPERVISOR

Pre-payroll file reviewed/approved online

Pre-payroll file uploaded to State Central Payroll; agency hard copy entered created/sent



AGENCY CENTRAL PAYROLL

Agencies send someone to pick up/sign for warrants, pay advises, reports

Warrants/pay advises distributed either at agency Central Payroll or at various divisions

Reports from State Payroll used to validate some data transactions, paired with original data forms, filed

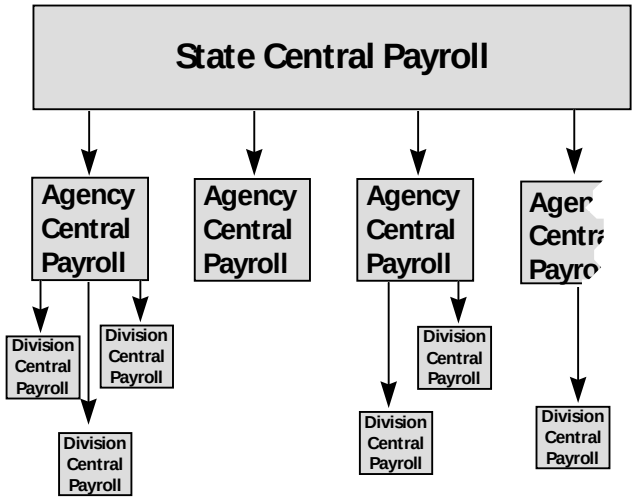
Agency Central Payroll staff respond to employee queries, develop/compile reports for employees/ managers on request

The Process

The Size of Payroll

Payroll is a very large process within the State.

- It is highly decentralized. Every agency is involved in payroll. There are at least three levels of payroll processing within State government - agency divisions, agency central payrolls, and State central payroll.
- About 900 employees have some direct contact with the process.
- The State's 1997 Biennium budget to pay salaries and benefits to its employees is $683.6 Million.*



x 30

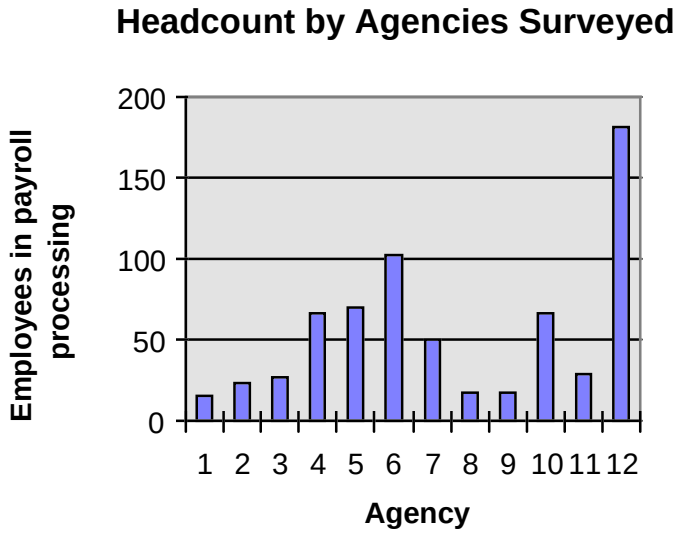
Payroll is sizable, complex, and one of the largest expenditure types within the State.

*Source: BUDGET ANALYSIS 1999 BIENNIUM - OVERVIEW & GENERAL REFERENCE prepared by Montana Legislative Fiscal Division, January 199

The Size of Payroll

An exceptionally large number of people are involved - At least 900 employees are involved in payroll in some capacity across the State.

- Many supervisors collecting and signing employee timesheets.
- At least one "pay contact" within each of the agency's divisions units.
- A core group of Agency Central Payroll clerks and supervisors.
- A group of State Central Payroll employees.

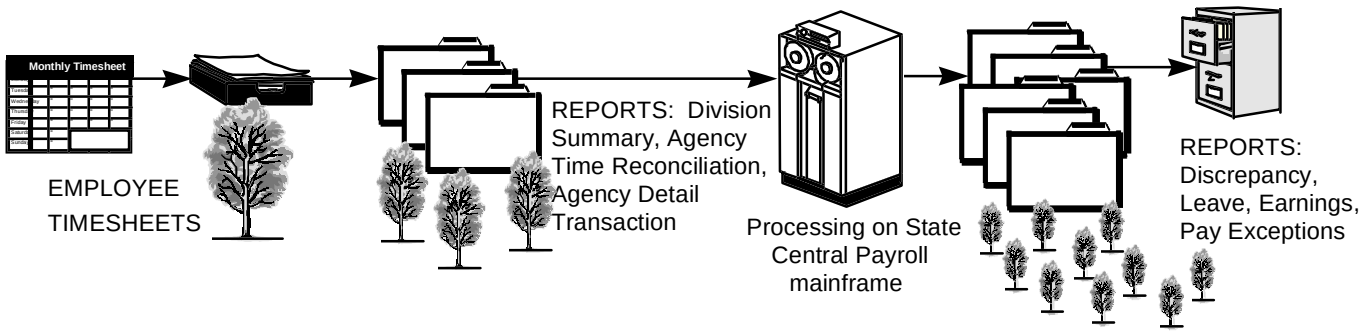


There is a large number of people doing work that does not add significant value to the organization. This results in fragmentation and duplication of effort.

The Complexity of Payroll

Considerable manual effort is exerted within a paper-based system.

- Even with a degree of automation, excessive amounts of paper reports and forms are produced.
- There is a preference for hard copy and microfiche reported.
- Although some steps have been taken to try to improve, online reports are either limited or are hard to use.
- Lack of online system edits creates a need for paper to reconcile.

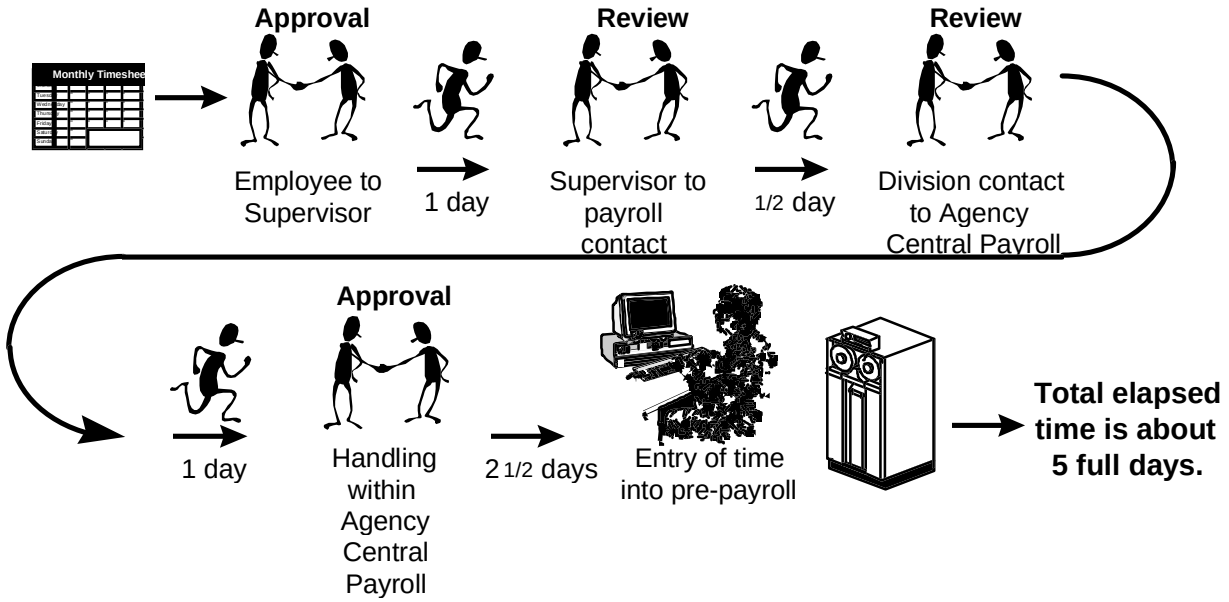


A significant amount of money and effort is being spent creating, using, and storing paper reports and forms.

The Complexity of Payroll

There are many steps, handoffs and approvals in capturing payroll data.

- A timesheet can be handled by as many as 4 different people *before* being entered into the mainframe system.

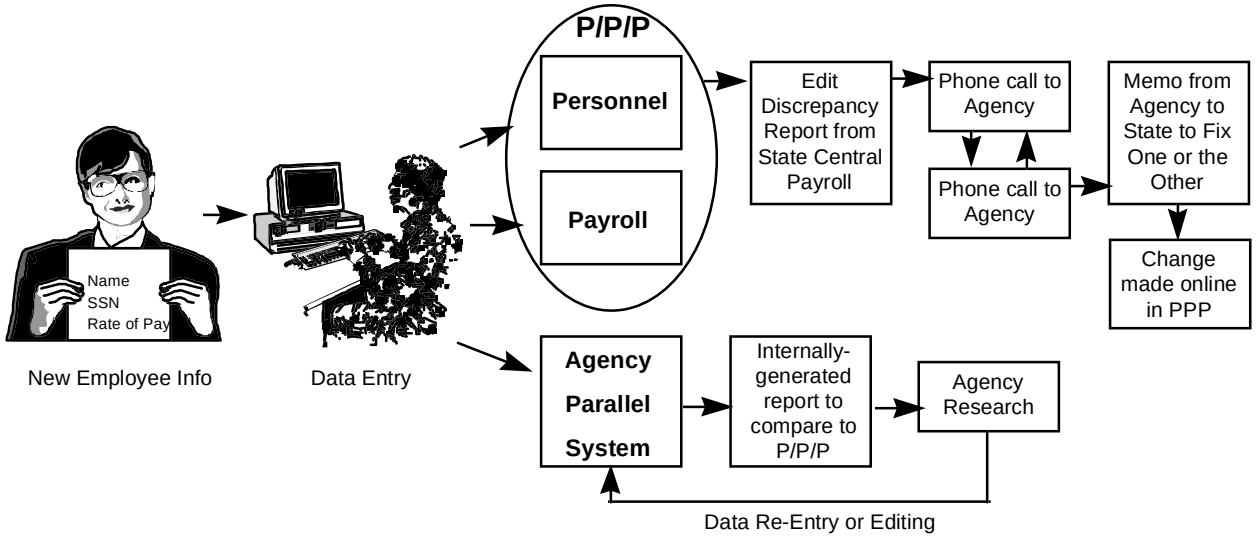


A considerable amount of time and cost is being expended through the entire payroll process because of multiple hand-offs and approvals.

The Complexity of Payroll

Information Systems are inadequate.

- Multiple data entries are often necessary, creating an entire process for detecting, reviewing and correcting data inconsistencies.
- A lack of functionality and user-friendliness has resulted in numerous parallel systems being maintained.



The lack of an integrated system results in inefficiency and ineffectiveness in information capture, tracking, sharing and storage.

The Payroll Process

The payroll process is characterized by extreme fragmentation of effort. There are at least 20 steps involving many different people and associated handoffs. There are multiple layers of approval, and manual checking, re-checking and entry of the same data.

People

- 900 Employees involved.
- Equating to 40 FTE.
- Fragmentation of effort is apparent.

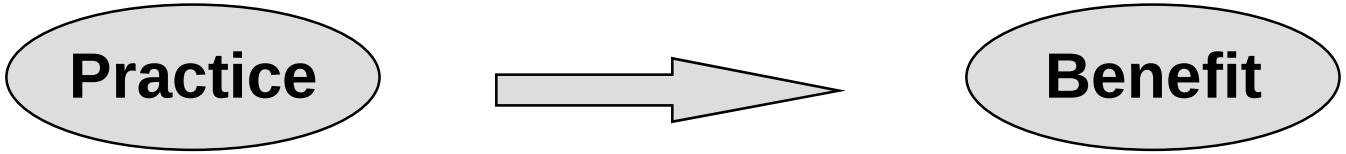
Process

- Many steps, handoffs, approvals.
- Paper-based.
- Considerable manual effort.

Systems

- Not integrated, duplicate entry.
- Parallel systems maintained.
- Lack functionality, user friendliness.

Agency Initiatives to Improve the Process



- Automated time entry is planned.
- Using e-mail to approve online adjustments of time by State payroll rather than sending hard copy memo.
- Entry of time into Lotus-type applications to perform basic editing and time summary.
- online system edits of time entry within parallel systems at agency central payroll.
- Electronic transmission of data from agency to State payroll.
- Spreadsheets being used to do some “what if” analysis.

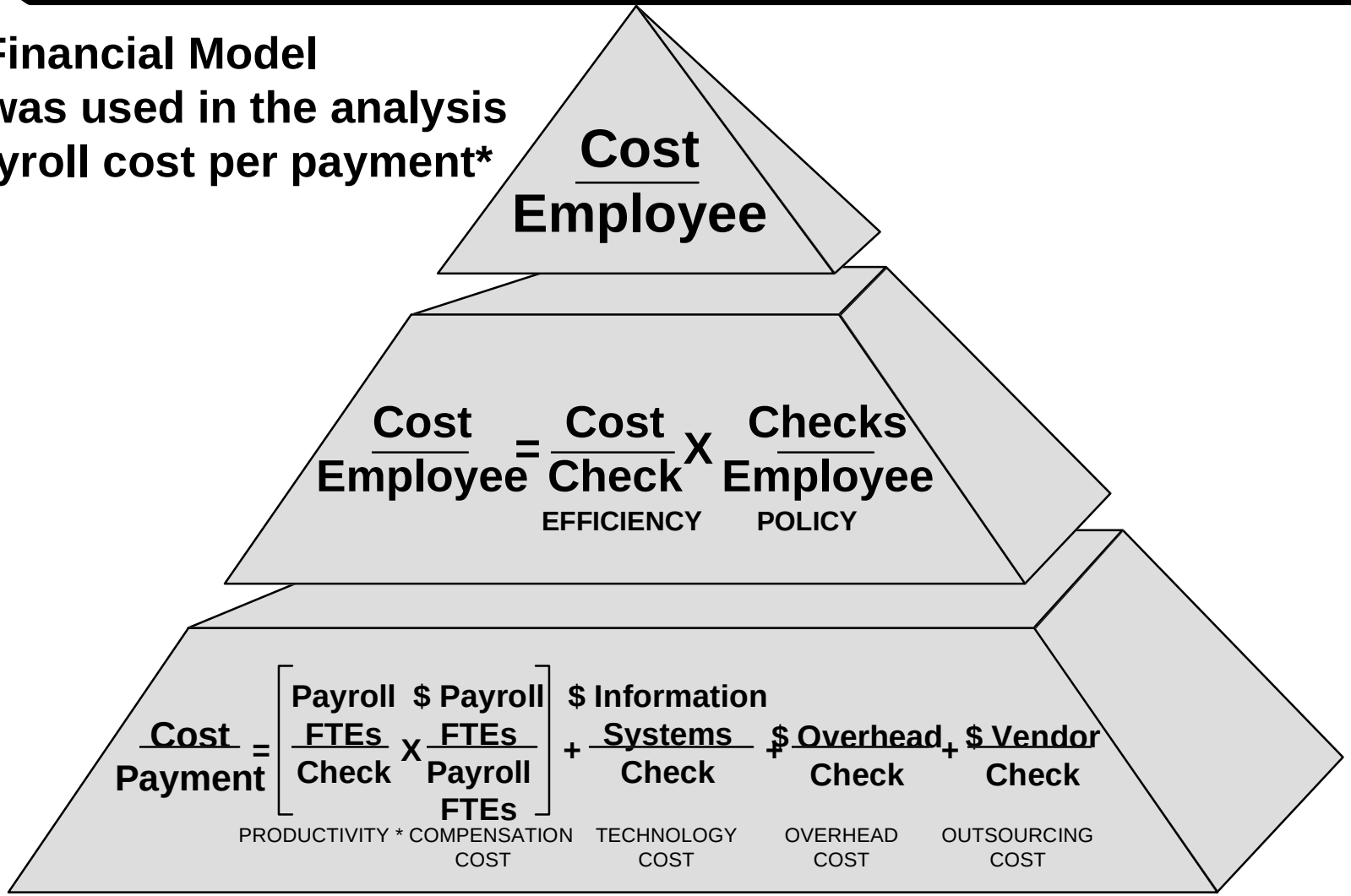
- Eliminates duplicate data entry and manual effort.
- Speeds the process by taking advantage of automating technology.
- Reduces manual effort, increases the accuracy of data entry.
- Reduces manual effort, increases the accuracy of data entry.
- Eliminates duplicate data entry.
- Provides a powerful tool for analysis and decision-making.

Despite these efforts there is a lack of coordination and leveraging across State government.

The Cost

The Cost of Payroll

The Financial Model that was used in the analysis of payroll cost per payment*



* Payments include both warrants and EFTs

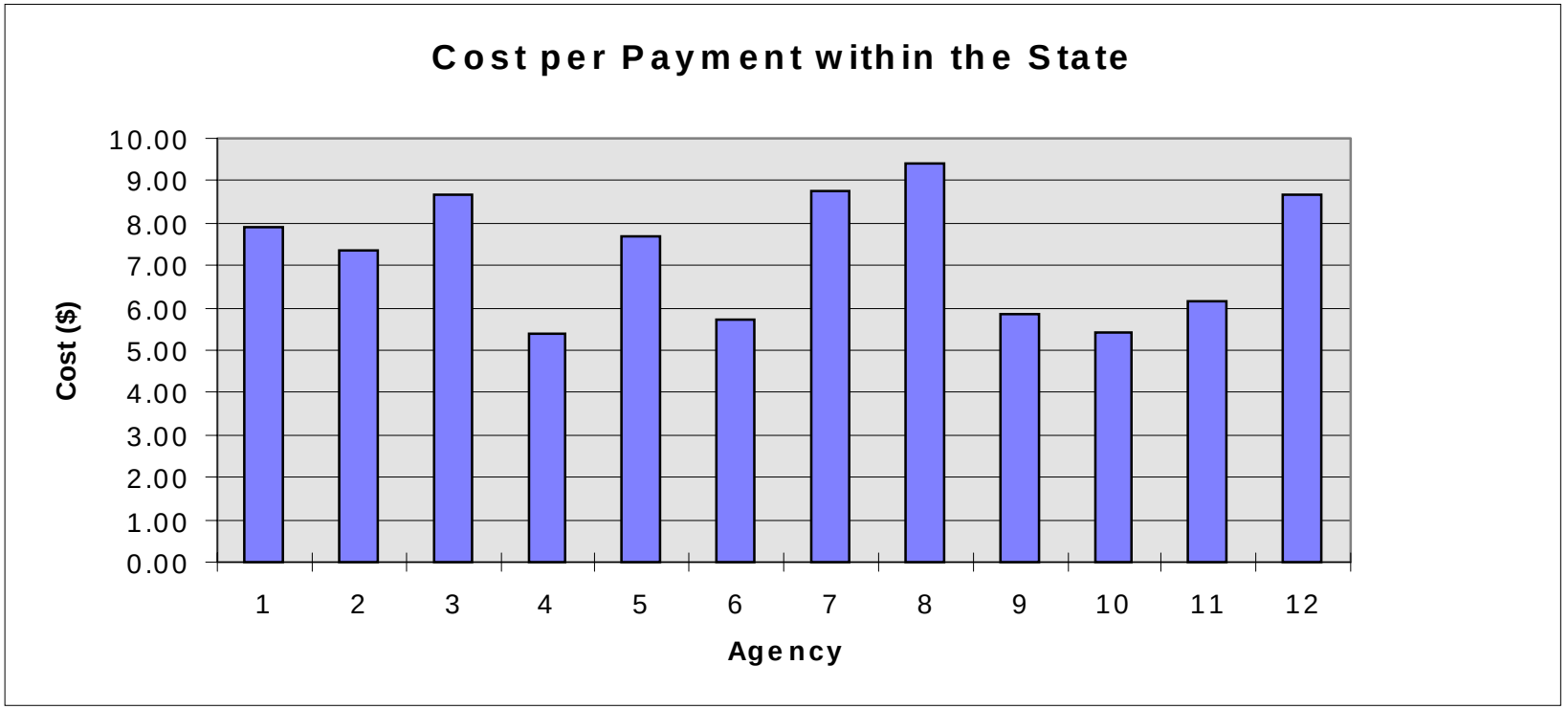
The Cost of Payroll

Cost per payment defined:

$$\frac{\text{Cost}}{\text{Payment}} = \left[\frac{\text{Payroll FTEs}}{\text{Check}} \times \frac{\$\ \text{Payroll FTEs}}{\text{Payroll FTEs}}\right] + \frac{\$\ \text{Information Systems}}{\text{Check}} + \frac{\$\ \text{Overhead}}{\text{Check}} + \frac{\$\ \text{Vendor}}{\text{Check}}$$

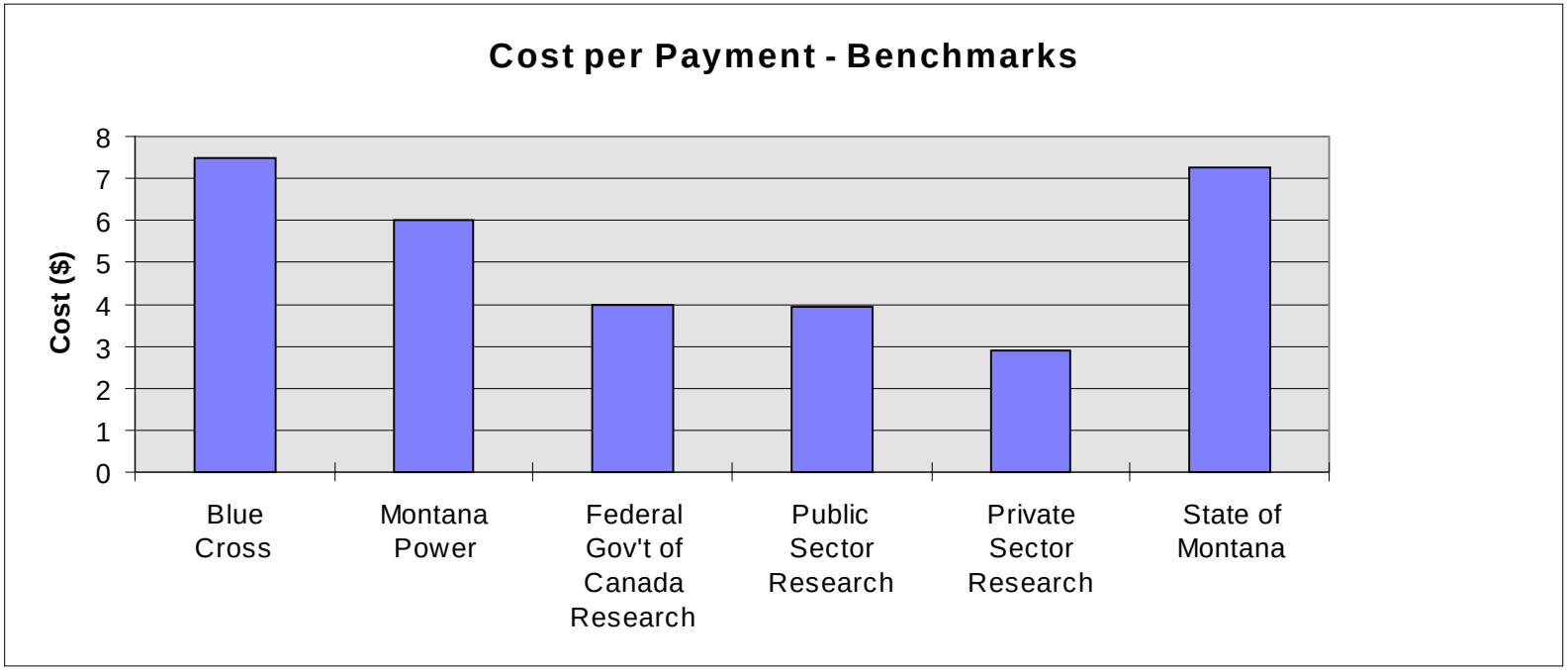
- **Payroll FTEs =** time spent on activity divided by 80 hrs
- **Check** = number of payments made (both warrants and EFTs)
- **$ Payroll FTEs** = time spent x rate of pay (marked up for benefits) x 26 pay periods
- **$ Information Systems**= cost assessed to the agency by central payroll for P/P/P plus any additional cost for internally maintained parallel systems
- **$ Overhead** = Personal services cost times 25% (average overhead cost)
- **$ Vendor** = costs assessed by outside vendors (none found in this review)

The Cost of Payroll



The average cost per payment is $7.25. Costs range from $5.41 to $9.39 which can be attributed to the degree of manual effort, the level of automation, and complexity of individual agency reporting/tracking requirements.

The Cost of Payroll-Benchmark Comparison



Compared to in-state research the State costs about $1.25 more per payment. Compared to the published mean public sector research the State costs $3.30 more, and $4.35 more than the published mean private sector research. The best private sector cost per payment is one quarter that of the State.

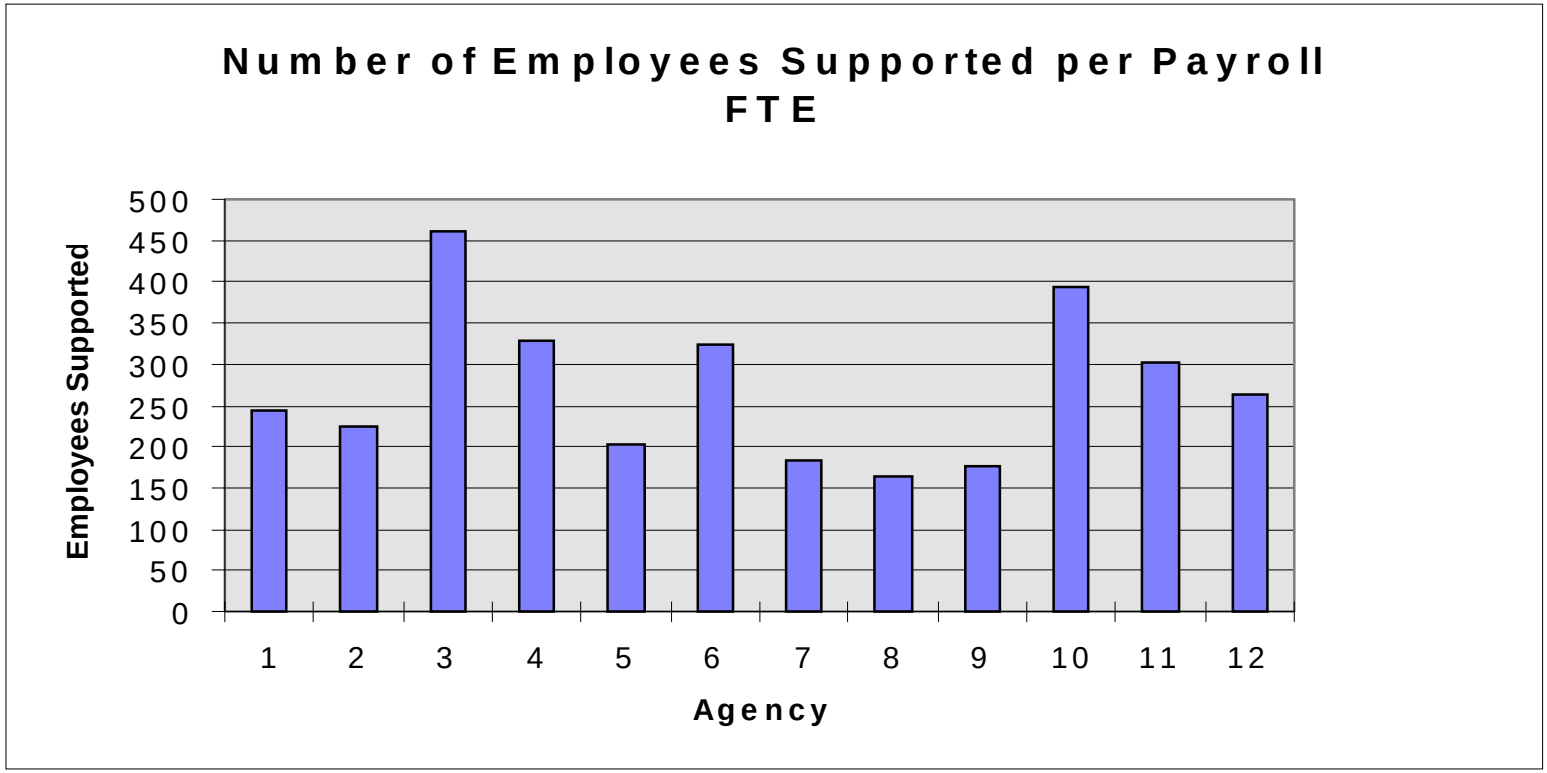
The Efficiency of Payroll

Number of Employees supported per payroll FTE defined:

$$\text{Number of Employees Supported per Payroll FTE} = \frac{\text{Total FTE}}{\text{Payroll FTE}}$$

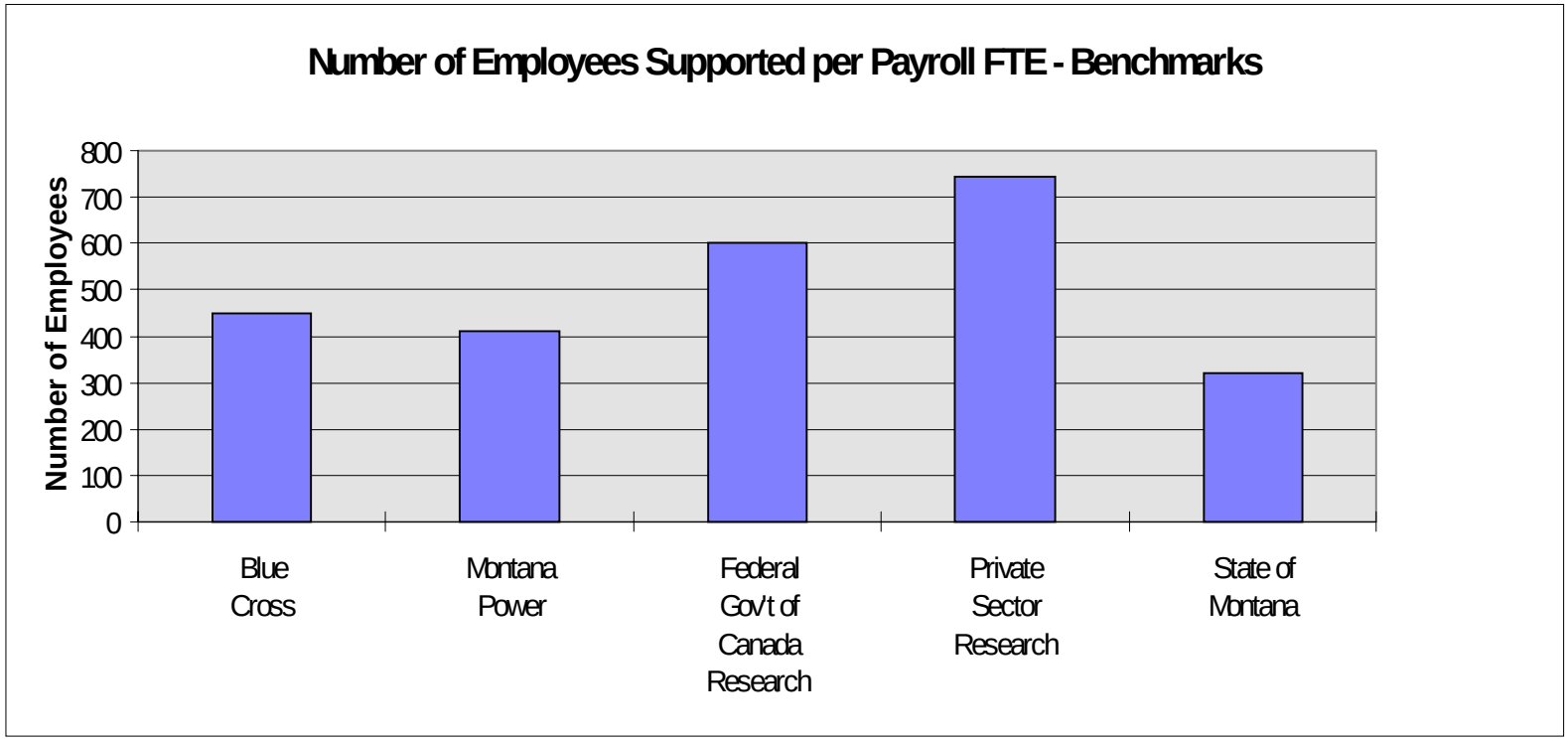
- **Total FTE** = the total FTE within each agency
- **Payroll FTE** = total hours spent within an agency doing payroll activities divided by 80 hours

The Efficiency of Payroll



The average number of employees supported per payroll FTE is 275. The range is from 165 to 460. The degree of manual effort, the level of automation, and economies of scale generally account for the variance.

The Efficiency of Payroll - Benchmark Comparison



In-state research supports about 150 more employees per payroll FTE. Mean published private sector research indicates that 475 more employees are supported per payroll FTE. The best private sector benchmark supports four times as many employees per payroll FTE.

The Opportunity

Opportunity Analysis

If the State was able to narrow the gap in terms of cost per payment there would be substantial annual cost savings.

	Potential Saving if State Best Is Achieved
State Mean	$7.25
State Best	$5.41
Difference	$1.84
Calculation	$1.84 x 297,691
Annual Saving	$547,750

	Potential Saving if Public Sector Mean Is Achieved
State Mean	$7.25
Public Sector Mean	$3.94
Difference	$3.31
Calculation	$3.31 x 297,691
Annual Saving	$985,350

	Potential Saving if Private Sector Best Is Achieved
State Mean	$7.25
Private Sector Best	$1.75
Difference	$5.50
Calculation	$5.50 x 297,691
Annual Saving	$1,637,300

The State could reasonably expect minimum savings of $550,000 annually and could potentially save $1,650,000 annually if cost per payment was reduced to best practice levels.

Opportunity Analysis

If the State was able to narrow the gap in number of employees supported per payroll FTE there would also be substantial annual cost savings.

State Best Efficiency

State employees supported per payroll FTE	State Best	Current State payroll FTE	Potential State payroll FTE at Benchmark Efficiency	Annual Potential Personal Service Savings (using $32,000 annual salary)
275	461	40	24	16 FTE x $32,000 = $512,000

Private Sector Mean Efficiency

State employees supported per payroll FTE	Mean Private Sector Benchmark	Current State payroll FTE	Potential State payroll FTE at Benchmark Efficiency	Annual Potential Personal Service Savings (using $32,000 annual salary)
275	744	40	15	25 FTE x $32,000 = $800,000

Private Sector Best Efficiency

State employees supported per payroll FTE	Best Practice Private Sector Benchmark	Current State payroll FTE	Potential State payroll FTE at Benchmark Efficiency	Annual Potential Personal Service Savings (using $32,000 annual salary)
275	1382	40	8	32 FTE x $32,000 = $1,024,000

The State could reasonably expect minimum savings of $512,000 annually and could potentially save $1,024,000 annually if efficiency was increased to best practice levels.

Benchmark Findings

Research of Montana Power Company has revealed that it is able to produce payroll payments for less and can service more employees per payroll FTE. Although neither Montana Power nor Blue Cross/Blue Shield are close to best practice levels, these organizations have implemented some innovative practices:

- Payroll and benefits software is integrated;
- Time entry software is interfaced with payroll software;
- There is only one level of payroll centralization; and,
- Information systems are capable of ad hoc reporting.

Benchmark Findings

Organizations who perform at best practice levels in terms of payroll cost and efficiency have managed to implement some key features:

- Implementing shared services (to share processing resources and expertise) for high volume transaction processing and tax reporting (explore within organization or with business partners);
- Centralizing and integrating a database for payroll and human resources related information to eliminate duplication in adding/changing employee records, to share organization data and to improve data integrity across the organization;
- Implementing online validation of all data input at source, prior to transmission for processing;
- Automating time capture using enterprise-wide enabling technologies (e.g. swipecard, voice response);
- Using workflow technologies to route time and attendance records for approval;
- Encouraging 100% direct deposit (electronic funds transfer) for payroll to reduce paper-flow;
- Automating payroll correction process (eliminate manual calculations and adjustments);
- Implementing process effectiveness performance measures (e.g. cost, cycle time, staff productivity, accuracy of transaction processing) and analyze for improvement opportunities;
- Enabling employees to update their own benefits/deductions using secure technologies (e.g. integrated voice response, employee kiosks).

Readiness to Change

State employees are ready for a change...

"We need one point of entry - no duplicate entry - one system does it all"

"It would be great if we could distribute information among all agencies"

"It would be very nice to have online history and adjustment capability and have a good audit trail so there aren't so many month-end adjustments"

"Treat us (agencies) as one employer so that when an employee transfers we don't need to set them up in the system again and again…"

"Half my work will be eliminated when there is an integrated data base with automated time entry"

"These systems are on life support - we now need to be Dr. Kevorkians"

Clearly there is a strong desire and need for change.